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Chapter

The New Trading Environment: Opening Markets

Much of Cambodia's trade performance as a WTO member will depend on using WTO disciplines and commitments to improve the regulatory environment, and to spur the necessary investment in services that will enhance productive capacity and competitiveness. Building world-class exporters will not be easy.

Smuggling across the Vietnamese and Thai borders is rampant, and must be defeated for Cambodia to realize its full potential as a trading nation. If producers and traders find informal trade routes, especially for the export of Cambodian raw materials, easier and more lucrative than formal trade, the WTO rules will have little impact.

Opening Foreign Markets

The most publicly recognized facets of the new trade environment will be, first, the extent to which foreign markets are accessible to Cambodian products and, second, the opening of the Cambodian market to more overseas competition. It is easy to exaggerate these effects. For the most part, the opening of the Cambodian market has already taken place, and the competitive effects have been absorbed over several years. As will be explained, the additional market opening for Cambodian products overseas is also limited. What counts is the degree to which the WTO ensures markets are not only open, but stay open. This security and predictability should give confidence to investors and traders.

Primary reform of the Cambodian customs tariff structure *(*see Box 12 below for tariff terms*)* took place in mid-2001, during the WTO accession process. At this time, a 12-band tariff structure was reduced to 4 duty rates (0, 7, 15 and 35%). Tariff rates at levels of 40%, 50%, 90% and 120% were eliminated completely, and the simple average applied rate was reduced from 17.4% to 16.5%. A second stage of tariff reform that would reduce the simple average below 15%, in particular by further reducing rates on imported raw materials for local industry, is due to be implemented. However, this phase of customs reform is not tied to the WTO agreement.

Box 12: Some definitions of tariff terms

1. *WTO bound tariff* – customs duty ceiling guaranteed and enforceable in the WTO.
2. *MFN rate* – duty level that applies to all other WTO members and other nations to which MFN conditions are freely offered (e.g. many countries applied MFN treatment to Cambodia even before it was a WTO member). An MFN rate can be a WTO bound tariff rate (all WTO bound tariffs must be MFN), or an applied rate. It could also be a rate offered by members of a regional trade arrangement (say, AFTA) to all trading partners outside the group.
3. *Applied rate* – the customs duty actually charged at the border. An applied rate can be applied on an MFN basis, but it can also be a preferential rate or a rate charged among members of a regional trade arrangement.
4. *Preferential rate* – an especially low, or zero, rate applied to all or some developing countries. The best examples are the GSP (Generalized System of Preferences), or the EU's "Everything but Arms" (EBA) initiative, for least-developed countries.

Cambodia offers some limited preferential (lower than normal) rates to its ASEAN partners[4] through the Common Effective Preferential Tariff (CEPT). Otherwise, all applied rates are MFN, which are the same for all countries. These CEPT rates are those actually *applied* to imports. The WTO negotiations were about the rates to be *bound*[5] as part of the accession agreement.

FUTURE TARIFF INCREASES

For many products, Cambodia bound its currently applied tariff rates in the WTO. In other words, traders can rely absolutely on the WTO tariff rate. For other products, the WTO bound rates, or bindings, are a few percentage points above the applied rates. For some sensitive items, the bound rate is much higher than the currently applied rate. For example, the bound rate on rice is 40%, while the applied rate is currently 7%. For many vegetable oils, the bindings are at 30% or 40%, while actual rates charged are at 7%. Binding on alcoholic drinks are 40% against an applied rate of 35%. For textile fabrics, the applied rate is usually 7% while the bindings are at 7%, 10%, and 12.5%.

Cambodia retains some freedom to increase its rates, if necessary, without running any risk of challenge within the WTO. At the same time, where it has kept bound and applied rates close, Cambodia is providing traders and investors with an important degree of security. And, to the extent that duties on basic household items are kept low, consumers will benefit, especially the poor.

Accession to the WTO does not mean a large-scale fall in applied tariff rates in Cambodia, which would result in an explosion of foreign competition. It is also important to keep in mind that imports are not bad. They permit Cambodian businesses and farmers to secure, at reasonable prices, capital goods and industrial/agricultural inputs. Very often, there may be no domestic capacity to produce these necessary items in Cambodia. Perhaps even more important, imports bring basic consumer items cheaply to poor people. So, it would be a mistake to see trade policy, under the WTO or not, as simply an effort to cut imports and build exports.

ADDITIONAL IMPORT CHARGES

The WTO rules tightly restrain the charges that can be made on imports over and above customs duties. Cambodia undertook not to impose any other duties and charges. Existing charges of US$0.02 and US$0.04 per litre imposed on petrol and diesel, respectively, were to be rolled into a new compound tariff rate.

Charges made for official services rendered at the ports, with respect to imports and exports, should be proportionate to the cost of the services provided. Thus, Cambodian authorities, notably Camcontrol and the customs department, may not charge fees on the basis of a fixed percentage of consignment/shipment values. Since, normally, the paperwork related to a single shipment is much the same, regardless of size or value, the fees charged should be standard. The WTO has noted the Riels 15,000 (US$4) fee charged per import/export declaration.

Internal taxes must not discriminate against imports. Excise taxes[6] are imposed in Cambodia on a range of drinks, tobacco products, petrol, and lubricating oil at 10%. These rates apply equally to domestically produced products. For motor vehicles and their spare parts, the excise tax ranges from 5%

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[4] ASEAN members: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

[5] A "bound" tariff means that any exporter or Cambodian importer has a guarantee that the customs duties to be applied to his goods cannot be any higher than the bound rate. It may be that the applied rate is lower than the bound rate, but that is not part of the WTO contract. If Cambodian exporters find themselves being charged import duties that are in excess of WTO bound levels, then they can insist the customs service concerned reduces the rates. Alternatively, they should complain to MoC in Phnom Penh, which could take up the matter on a government-to-government basis.

[6] An excise tax is an indirect tax charged on domestic and imported groups in a small number of product categories. Excise taxes in Cambodia have been largely replaced by VAT.

to 110%. A special 3% tax on imported alcohol and tobacco products was applied to domestically produced items in 2002.

The VAT regime operating in Cambodia is also subject to the same requirements for non-discrimination between domestic and imported products (national treatment), and among foreign suppliers.

Market Access Opportunities for Cambodian Companies

Just as the influence of WTO accession on the further opening of the Cambodian market is limited, the influence on additional market access likely to be available to Cambodian exporters is also limited. Cambodia already benefits from many favorable trade relationships. Where they do not enjoy preferential access terms, its exporters seldom have to pay duties above the local MFN applied rates.

This is not to deny the value of WTO membership as a vehicle for enhancing Cambodia's export potential. But, the benefits from better tariff treatment in key markets will, on the whole, be limited. As is the case for foreign companies exporting to Cambodia, the principal market access advantage for Cambodian producers in export markets will be the security of the bound tariffs committed by all other WTO members. Thus, in almost 150 countries, Cambodian exporters will have a guaranteed ceiling to the customs duties they can be charged by customs authorities.

The practical reality is that the trading conditions that Cambodian firms will need to master are very complicated. As has already been discussed, the global trading system is now fragmented by regional, bilateral and preferential trading arrangements. As an LDC, and a member of the ASEAN Free Trade Area (AFTA), Cambodia benefits from many such arrangements. The following paragraphs explain some of the most important of these arrangements.

1. Levels of bindings and applied duty rates

Although Cambodia has committed to bind its entire tariff in the WTO, and has relatively small differences between the bound duties and the actual (applied) duties it charges importers, that is not the case for many developing country WTO members. For most developing countries that were previously members of GATT, there has been little pressure to bind tariffs.

India, for instance, has bound less than 75% of its tariffs, though this is a big improvement on the situation in the 1980s, before the Uruguay Round. The average level of bound tariffs in India is 51% (116% for agricultural products, and 38% for industrial products). India's applied rates average around 30%. Thailand has a very complex tariff structure with fewer than 75% of the lines bound. The average bound rate is 28%, while the simple average applied rate is around 15%.

In contrast, Vietnam and Laos, currently negotiating WTO membership, are likely to be required to bind most, if not all, of their tariffs, and to fix bound rates reasonably close to applied rates. In joining the WTO, China bound its entire tariff with a 15% average (maximum 65%) for agricultural products, and 8.9% (maximum 47%) for industrial goods.

2. GSP schemes

For some major industrial country markets, especially the US, it is the availability of tariff advantages under the Generalized System of Preferences (GSP) that will continue to be important for Cambodian exporters.

GSP benefits cannot be guaranteed in the WTO, and their application is often subject to arbitrary decisions by the importing countries. As is particularly the case for the US scheme, "sensitive" products may not be covered; a problem for Cambodian garment and footwear manufacturers. In recent years, the observation of international labor standards has become an active criteria for the US and European Union (EU) schemes. Cambodia, which has a positive reputation for upholding labor standards, has little to fear in that sense. The US also applies criteria relating to the protection of IPR.

Other potentially distorting factors have been the special advantages offered to countries fighting drug trafficking or terrorism and, in the case of the EU, environmental protection.

Although all developing countries can qualify for most GSP schemes, there is increasingly a view in the industrial world that it should be the poorest nations that receive the most benefits. It has been proposed, for instance, that the EU GSP scheme for 2006 - 2015 target LDCs and be simplified. This may assist Cambodia, especially if, as proposed by the EU Commission, the new scheme also improves the application of rules of origin (See Annex D on the garment sector).

The following countries grant GSP schemes: Australia, Belarus, Bulgaria, Canada, the European Community, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey, and the US. Imports under the EU scheme accounted for about $66 billion in 2002, while the US imported about $20 billion under its version. In 2001, Cambodia's GSP exports were worth US$1142 million of a total US$1374 million.

Handbooks on the major GSP schemes provide a reasonably clear summary of countries and products covered, as well as the rules of origin applicable, usually the most difficult aspect of GSP conditions. They can be found on the United Nations Conference on Trade and Development (UNCTAD) website at: http://www.unctad.org/Templates/Page.asp?intItemID=1421&lang=1

3. EU – "Everything But Arms"

More recently, some Cambodian exports have been covered by a new preferential deal in the EU for LDC's called "Everything but Arms" (EBA). This arrangement provides duty-free and quota-free access to almost all the imports of least-developed countries. Unfortunately, the rules of origin used for EBA imports are restrictive, especially for the Cambodian garment industry, which is not integrated and currently relies extensively on imported inputs.

Other industrial countries, though not the US, have put in place similar schemes in favor of least-developed countries. Included in the declaration that launched the Doha Round was a commitment, by all WTO members, "to the objective of duty-free, quota-free market access for products originating from least-developed countries".

4. ASEAN and AFTA

Cambodia is a member of only one regional trade agreement: AFTA. Clearly the trading conditions operating within ASEAN will significantly impact the local export performance of Cambodia. AFTA will require Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand to eliminate most import duties by 2010. The remaining AFTA signatories, Cambodia, Laos, Myanmar and Vietnam, have until 2015 (with some possible flexibility) to eliminate duties on products on their "inclusion lists," with different transition periods applying to various sensitive products.

Under an "early harvest" agreement, Thailand offers duty-free treatment to Cambodia (as well as Laos and Myanmar) on products within 43 tariff headings, particularly on fish products, fabrics, and garments.

AFTA does not only apply to tariffs, but to non-tariff measures, IPR, services, standards, rules of origin, trade facilitation, and other trade policy areas. In some respects, it goes further than the WTO rules and commitments.

5. China

A China-ASEAN Free Trade Area is currently being negotiated. Under an "early harvest" program, China provides duty-free treatment to Cambodia (along with Laos and Myanmar) on 297 products. The list includes mainly agricultural and fisheries items, but also some garments, footwear, and furniture products.

6. Bilateral agreements

From 1993 onwards, Cambodia concluded 24 bilateral agreements that included MFN tariff treatment with 13 countries, notably, China, Indonesia, Malaysia, Vietnam, Laos, Russia, the US, the EU, the Philippines, and Thailand. Those agreements with current WTO members are now, in practice, largely superseded by the WTO accession terms. The textile and clothing trade agreements with the US and EU are covered in the annex on the garment industry.

Exporting companies in Cambodia need to deal with varying market access conditions across the globe. The practice in the past has often been to ship products, usually in an unprocessed form, to neighboring countries, and let manufacturers and traders there deal with the complications of onward sales. If Cambodia wishes to secure the value added of direct sales, including for processed products, then local companies will need to understand many markets.

Unfortunately, determining duty rates is often a small part of the overall challenge of understanding market conditions, as Chapter 8 explains.

TAXES, CHARGES AND RESTRICTIONS ON EXPORTS

During the accession negotiations, Cambodia was questioned about its export taxes, charges, and restrictions. These are generally discouraged by the WTO, even where they are not clearly contrary to the WTO rules, since they tend to distort international trade. For instance, they can unfairly and unjustifiably deny access to raw materials for foreign manufacturers. However, Cambodia did not agree to change its current practices, other than to implement them within the terms of WTO provisions.

The main products subject to export taxes, and their rates, are:

- Cattle and pigs for breeding 10%
- Live fish and fish products 10%
- Shellfish and their products 10%
- Natural rubber and rubber waste 10%
- Unprocessed or semi-processed wood 10%
- Sawn and shaped wood and wood sheets 5%

Export quotas and prohibitions exist to meet a variety of policy objectives. Consistent with WTO exceptions, pharmaceuticals and medical materials require permits, and exports of narcotic drugs and poisons are prohibited (a WTO exception is made for the protection of human health). The export of round and sawn logs is prohibited, and wood products are under quota to protect exhaustible natural resources. Weapons, explosives, ammunition, and military vehicles and machines are subject to non-automatic licensing, as they are essential security interests. The export of antiques more than 100 years old is prohibited to protect national treasures.

Quotas restraining the level of rice exports were removed in 2001. However, Cambodia told the WTO it wished to retain the right to reintroduce restrictions in the event of critical shortages of foodstuffs.